

Decision 06-06-059 June 29, 2006

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In The Matter of the Application of Lodi Gas Storage, L.L.C. (U-912-G) for Approval of Long-term Financing Pursuant to Public Utilities Code Section 851.

Application 05-08-030
(Filed August 24, 2005)

**OPINION GRANTING LODI GAS STORAGE AUTHORITY
FOR LONG-TERM FINANCING**

A. Summary

This decision grants the request of Lodi Gas Storage, L.L.C. (LGS) for authority to issue or otherwise incur up to \$110 million in secured long-term debt, and to enter into financial hedging contracts for the purpose of managing interest rate risks. This proceeding is closed.

B. Background and Summary of Request

LGS seeks authority from the Commission under Sections 816 and 851 of the Public Utilities Code to issue up to \$110 million in long-term debt and to secure this debt with its assets. These sections require Commission review and approval before a utility may enter into such transactions. In addition, LGS requests authority to engage in transactions involving contracts for the purpose of managing the variable interest rates associated with its debt. The terms and conditions for the proposed financing are attached to LGS' application.

LGS is a Delaware limited liability company that operates a natural gas storage facility (Lodi Facility) which is northeast of the City of Lodi and

interconnects with Pacific Gas and Electric Company's (PG&E) intrastate Redwood Pipeline Systems (Line 401) at the Sherman Island Interconnect. Lodi Facility began operation in 2002 after receiving a Certificate of Public Convenience and Necessity from the Commission in Decision (D.) 00-05-048, amended by D.03-08-048 and D.04-05-046. It provides gas storage services at market-based rates to customers who take service voluntarily.

By D.05-12-007, the Commission granted authorization to transfer Western Hub's 50% interest in Lodi Holdings, the parent company of LGS, to WHP Acquisition II (WHP II). This transfer of control changed the ultimate ownership of LGS and the Lodi Facility, but maintained the terms and conditions under which LGS operates the Lodi Facility.

C. Discussion

1. Request to Issue Up to \$110 million Long-term Debt

We grant LGS' request for authority to issue up to \$110 million in secured long-term debt. LGS filed its request for the new financing authority at the same time it applied for authority to transfer control to WHP II. However, the transfer of control application was approved in an earlier decision without the financing authority and the cost of acquisition was funded with equity by the new owner, WHP II.¹ According to LGS, because the financing application was not approved at the same time as the transfer of control, the acquisition costs were funded with

¹ D.05-12-007

equity until such time as the financing application would authorize the issuance of debt².

The Commission has broad discretion under Section 816 to determine if a utility should be authorized to issue debt. The primary standard used by the Commission is whether a utility has demonstrated a reasonable need to issue debt for proper purposes. Section 817 lists the various purposes for which debt may be issued and provides, in pertinent part:

“A public utility may issue stocks and stocks certificates or other evidence of interest or ownership, and bonds, notes, and other evidences of indebtedness payable at periods of more than 12 months after the date thereof, for any one or more of the following purposes and no others:

.....

(f) For the reorganization or readjustment of its indebtedness or capitalization upon a merger, consolidation, or other reorganization.”

Based on the particular facts recited above, especially the fact that the transfer of control and refinancing are part of a single plan of action, we conclude that the requested financing is authorized by Section 817 (f). Furthermore , the new financing arrangement is reasonable. Because LGS is authorized to provide service at market-based rates to customers who take service voluntarily, we are

² According to LGS, the new financing will result in 45-50% debt-capital ratio. However, based on the information obtained by the Energy Division through data request, it appears that the 45-50% ratio was calculated based on LGS’ debt to total enterprise value ratio. Although LGS has used a different method to calculate debt ratio in this application, in approving LGS’ request, we are not departing from our practice of using book value of debt and total asset in calculating debt ratio for utilities that are subject to rate-of-return regulation.

not concerned here with the fact that the cost of acquisition will now be reflected as a debt of the operating utility. In contrast, in the case of a cost-of-service utility, we definitely have concerns if the utility seeks authority to be liable for its own acquisition debt. Therefore, we authorize LGS' request for \$110 million of secured financing. However, in its application, LGS has mentioned that it is in preliminary discussions with lending institutions for an additional \$20 million. We remind LGS that any request beyond the \$110 million must be filed with the Commission for approval.

Further, we grant LGS' request to secure the proposed financing by a perfected, first security interest in all of its assets. Section 851 provides that:

"No public utility..... shall sell, lease, assign, mortgage, or otherwise dispose of or encumber the whole or any part of its line, plant, system, or other property necessary or useful in the performance of its duties to the public, without first having secured an order from the commission authorizing it to do so."

In authorizing an encumbrance, the Commission needs to determine if the transaction will adversely affect the public interest. As stated in D.01-08-023, LGS operates as a utility providing competitive gas storage services to customers who take service voluntarily. LGS' shareholders bear the complete risk of LGS' operations and investments. Under these circumstances, ratepayers bear no risks with respect to LGS' activities, and thus public interest will not be adversely affected by LGS securing its debt with its assets.

2. Request to Enter into Contracts to Manage the Risk of Variable Interest Rates Associated with Outstanding Debt

We grant LGS' request for authority to enter into financial contracts such as interest rate swaps, cap agreements, collar agreements and option agreements,

because these types of financial tools are commonly used to manage the risks associated with floating interest rates of debt. For example, interest rate swaps provide for the exchange of a series of interest rate payments between two parties. In an interest rate swap agreement, one party may convert fixed rate payments into more favorable floating rate payments or visa versa, or convert a floating-rate payment tied to an index to another index. Caps, collars and options also provide other means of reducing the variability of interest payment associated with floating interest rate debt. The use of these financial tools may help LGS manage its interest payment better. Therefore, it is reasonable to grant LGS' request.

3. The Motion to File Financial Statement and the Terms and Conditions for the Financing under Seal

LGS is seeking confidential treatment of both its financial statement and the proposed long-term financing terms and conditions. LGS asserts and we agree that they contain commercially sensitive information that should not be disclosed publicly. We find LGS' request for confidential treatment of the above information reasonable and grant its motion. Accordingly, Attachment C and D of LGS' application should remain under seal for a period of two years from the effective day of this order. If LGS believes that protection is needed beyond two years, it may request for further protection in a motion.

D. Procedural Matters

Besides the motion to file under seal, LGS filed a motion for an order shortening time to respond to its Application. This motion is moot.

On September 13, 2005, PG&E filed a response to LGS' application stating its interest in the application. LGS filed a reply to PG&E's response. No protest was filed.

On June 14, 2006, LGS filed a motion to provide additional information in support of its application. This motion is granted.

E. Categorization and Need for Hearing

In Resolution ALJ 176-3158, dated September 8, 2005, the Commission preliminarily categorized this proceeding as ratesetting and preliminarily determined that hearings were not necessary. No protests have been received. Given this status, public hearing is not necessary and it is not necessary to alter the preliminary determination made in Resolution ALJ 176-3158.

F. Waiver of Comment Period

This is an uncontested matter in which the decision grants the relief requested. Therefore, the otherwise applicable 30-day period for public review and comment is being waived pursuant to Public Utilities Code Section 311(g)(2).

G. Assignment of Proceeding

John A. Bohn is the Assigned Commissioner and Maryam Ebke is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. LGS has requested authority to issue debt under Sections 816 and 851.
2. LGS' request for financing authority is part of its overall plan to transfer a 50% interest in the utility to WHP II.
3. LGS provides gas storage services at market-based rates to customers who take service voluntarily.
4. Allowing LGS to secure its debt with its assets will not adversely affect the public interest.
5. It is reasonable to use financial tools such as swaps, caps, and collars to manage interest rate payments.

6. Attachment C and D of LGS' application contain competitively sensitive information.

7. No protests have been filed in this proceeding.

8. A hearing is not required.

Conclusions of Law

1. The requested financing authority is allowable under Section 817 (f).

2. The application should be granted.

3. Attachment C and D of LGS' application should remain confidential and under seal. These materials should not be made accessible or disclosed to anyone other than Commission staff processing the application. If LGS believes that protection is needed beyond two years, it should request further protection in a motion.

4. This proceeding should be closed.

5. This order should be effective immediately.

O R D E R

IT IS ORDERED that:

1. Lodi Gas Storage, L.L.C. (LGS) is authorized to issue long-term debt for up to \$110 million and to secure the financing by a perfected, first security interest in its assets. LGS is authorized to enter into contracts for the purpose of managing the variable interest risk associated with its outstanding debt.

2. Attachment C and D of LGS' application shall remain under seal for a period of two years from the effective date of this order, except upon further order or ruling of the Commission or Administrative Law Judge then designated as the Law and Motion Judge. If LGS believes that further protection of sealed information is needed beyond two years after the effective date of this order, it

may file a motion stating the justification for further withholding of the sealed information from public inspection, or for such other relief as the Commission

may provide. This motion shall be filed no later than 30 days before the expiration of this ordering paragraph.

3. Application 05-08-030 is closed.

This order is effective today.

Dated June 29, 2006, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners